

## **Withholding Tax on Payment to Non-Residents**

### **Income Tax Law No. 21 of 2009**

#### **1. Introduction**

The Income Tax Law No. 21 of 2009 which is effective from January 2010 has introduced withholding tax on payment to non-resident outside the state of Qatar. The regulation issued in June 2010 has explained the tax law in details and laid the procedure for effective implementation.

The issue of withholding tax being new to Qatar has thrown up questions on the need of withholding tax on several types of transactions. This is especially relevant where there are double taxation avoidance agreements (tax treaty) which make certain incomes non-taxable in the state of Qatar. The question of treaty overrides is an important issue which needs to be considered while determining the taxability of each transaction with non-residents. Qatar has entered into double taxation avoidance agreement with more than 40 countries. These are sovereign binding agreements on the taxability of several sources of income or transactions.

The provision of withholding tax law number 21 of 2009 is conferred in Article 11 in section 2 of chapter titled as 'calculation of tax'. The Article 11 is reproduced as under:

*“The tax rate shall be (10%) of the taxable income of the taxpayer during the taxable year. Notwithstanding the provisions of the previous paragraphs, the tax rate shall be as follows:*

- 1. a) The rate of tax provided for in agreements to which the Government, the Ministries or other governmental bodies or public bodies or enterprises are a party, which are concluded before the entry into force of this law, shall apply. If such agreements do not specify a tax rate, the tax shall be levied at the rate of (35%) thirty five percent.*  
*b) The tax rate and all other tax conditions provided for in agreements relating to oil operations as defined in Law No. 3 of the year 2007 concerning the exploitation of natural wealths and their resources shall apply provided that, in all cases, the tax rate shall not be less than 35% thirty five percent.*
- 2. Subject to the provisions of tax agreements, payments made to non-residents with respect to activities not connected with a permanent establishment in the State shall be subject to a final withholding tax, as follows:*

- a. *(5%) five percent of the gross amount of royalties and technical fees;*
  - b. *(7%) seven percent of the gross amount of interest, commissions, brokerage fee, director's fee, attendance fees and any other payments for services carried out wholly or partly in the State.*
- a. *5% (five percent) of the gross amount of royalties and technical fees;*
  - b. *7% (seven percent) of the gross amount of interest, commission, brokerage fee, director's fees, attendance fees and any other payment of services carried out wholly or partly in the State."*

## **2. Scope of Article 11**

The Article 11 provides for deduction of withholding tax on royalties, technical fees, interest, commission, brokerage fee, attendance fee and any other payments for services at the rate of 5% or 7% as the case maybe. What this Article implies is that wherever there is an element of income within the transaction of rendering of services would qualify for attraction of withholding tax. It is not the case of the tax law to bring payments of the nature of import, export, trade transactions within the purview of withholding tax. Similarly, it is not the case of tax law to bring the re-imburement of various expenses within the purview of withholding tax. However, where, the re-imburements also contain an element of income and are of composite nature, they shall be subjected to withholding tax. However, the key of levy of withholding tax is also the categorisation of transaction. Certain transaction may appear to be trade transactions or sales (for example; sale of software with copyrights) but in fact could be categorised as payment for royalty and liable for withholding tax.

## **3. Payment – Meaning**

The deduction of 5% or 7% arises only at the time of payment made. The word 'payment' implies remittance or actual payment. It does not imply withholding tax at the time of provisioning in the books of accounts. This can be derived from the dictionary meaning of the word 'payment' as the word 'payment' is not defined in the tax laws. The dictionary meaning of the word 'payment' means the action or process of paying someone or something or of being paid Secondly, Article 6 read with the regulation permits the accrual system and the

cash system and there is a clear understanding what is meant by payment. Thirdly, a reference to clause 1 of the Article 21 of the regulations also uses the word ‘paid’, where it states that the withholding tax is to be deducted when paid by person to non-resident.

Therefore, the withholding tax will have to be deducted only at the time of payment or remittance and not otherwise.

All payers have been covered and include individuals carrying on activity in the state and legal person resident in the state. It can be argued that the individual who are not carrying on any activity [defined in Article 1 as any business or profession or vacation] are not required to withhold tax for example; interest paid on personal loans to non-residents.

#### **4. Non-Resident – Meaning**

Withholding tax to be deducted at the time of payment to ‘non-residents’ and therefore, this term assumes significance. The tax law has defined ‘Residents’ in Article 1. The term “Non-Resident” although not defined separately would include natural person or body corporate who do not fulfil **all three conditions** of the Residency. There are three conditions required to be complied with by natural persons or corporate for being Resident.

In case of natural persons, namely individuals, residents would be persons who have a permanent home in state of Qatar or has been in state of Qatar for 183 days continuously or collectively during 12 months period or who has his center of vital interest in the state. In case all three conditions are not fulfilled, the person would be a non-resident.

In case of corporate, test of residence would be complying with anyone of the three conditions namely:

- a) It is incorporated under the Qatari Laws;
- b) Its head office is situated in the state;
- c) Its effective management is situated in the state.

In case, all three conditions are not fulfilled, the body corporate would be a non-resident.

In case of branches of foreign companies, the test of residence would fail as the effective management would be situated outside the state. Such entities would be considered as non-residents.

## 5. Tax treaties

Withholding tax in Article 11 is “subject to the tax agreements”. This is significant as Qatar has over 40 treaties with other countries. Article 11 therefore recognises the supremacy of the double taxation avoidance agreement by making the withholding tax “subject to the tax agreement”. While this publication does not analyse all treaties, it is important to note that tax law of 2009 recognises the source rule where it seeks to tax all incomes wholly or partly arising in Qatar.

However, the supremacy of the double tax avoidance agreement is implemented by first deduction of withholding tax and then refunding the same. This will pose difficulties for non-residents.

Clause 1 of the regulation 22 uses the word “shall” be deducted and further provides the procedure to obtain the refund. The treaty override is observed but with a procedure which first provides for deduction of withholding tax and a claim from the tax department. Worldwide, such procedure has been found to be cumbersome and there are difficulties in claiming tax refunds. The procedure of certification by independent accountants to bankers is one of the ways adopted to ease procedures and allow remittances freely wherein the treaty provides for taxability in the source country.

## 6. Gross Amount – Meaning

The withholding tax of 5% or 7% is on the “Gross Amount”. Gross Amount indicates that where agreement provides for payment of sums “net of taxes”, in that case appropriate grossing up would have to be done to ascertain the “Gross Amount” on which withholding tax is to be deducted. For example; where an agreement provides for deduction of 5% on royalties net of taxes, the amount to be paid would be grossed up as under:

$$\frac{\text{Sum to be paid net of taxes} \times 100}{95}$$

The 5% withholding tax to be deducted on this “Gross Amount”.

## **7. Re-imbusement of expenses**

The general principal of the Income Tax is that an income can be taxed and not the cost element for earning such an income. Therefore, the taxability of the re-imbusement is an important issue.

The term “re-imbusement” is not defined in the Income Tax Law of Qatar and hence its meaning to be understood in the common parlance. As per concise oxford dictionary the term “reimburse” means repay (a person who has expended money) or repay (a person’s expenses). The tax withholding on expenses/costs reimbursed to a non-resident do not give rise to any chargeable income in the hands of a non-resident and going literally by the principle of Tax Law, the reimbursement may not be subject to tax withholding, if supported by the adequate bills, invoices and supporting evidences of expenses made by the recipient. Moreover, if the recipient of reimbursement has merely acted as an ‘agent’ for recovery of the expenses incurred by it, such reimbursement may not be subject to tax withholdings.

The following types of reimbursement/costs may not be taxable:

- (i) Re-imbusement of incidental expenses in addition to payment of Royalty or Technical Fees.
- (ii) Re-imbusement of allocated cost (cost sharing).
- (iii) Payment of services rendered at cost.
- (iv) Re-imbusement of living allowance, travelling expenses of the engineers depute for carrying out design etc under a royalty agreement, etc.

The allocated cost of branch upto 3% has been specifically exempted by Article 21 read with Article 19. The words “*any other payment of services*” used in Article 11 cannot extend the arena of withholding tax to cover re-imbusements.

## **8. Withholding tax on payment to PE**

Permanent Establishment (PE) has been defined under Article 1 as a *fixed place of business through which the business of a taxpayer is wholly or partly carried on, including, for instance, a branch, office, factory, workshop, mine, oil or gas well, quarry, a building site, an assembly project or a place of exploration, extraction or exploitation of natural resources. Permanent establishment also includes the activity carried on by the taxpayer through a*

*person acting on behalf of the taxpayer or in his interest, other than an agent of an independent status.*

No withholding tax has been proposed on amounts paid to a PE established in the state of Qatar. This is specifically provided in Article 23 of the Regulation. As per Article 23 of the Regulation, the tax shall not be withheld on amounts paid to persons whom a tax card has been issued, in accordance with Article 27 of these regulations. This applies in particular to amounts paid to a PE of a non-resident person in the State.

The tax laws and Regulations provide for issue of a tax card to non-residents having a PE (Regulation 25-27). Where the non-resident has a tax card no withholding tax would be required to be deducted.

#### **9. Withholding tax on payment by PE to its HO**

Payment by PE to its HO/Parent/Head office/ Holding Company would at times involve payment of interest, re-imburement of expenses, head office administration and general services as contemplated in Article 19 of Regulation and other direct expenses. Withholding tax on payment of interest to head office by the PE branch is specifically exempted by clause 4 of Article 21 of Regulation. Reimbursement of expenses which has no element of income and is supported by invoices would in our opinion not attract withholding tax. Head office and general expenses upto 3% as contemplated in Article 19 of Regulation specifically exempted by clause 1 of Regulation 21. It appears that payment beyond 3% would attract withholding tax.

#### **10. Withholding tax on Exempt Incomes**

The tax law in Article 4 provides for tax exemptions. While a need to withhold tax on exempt income is debatable issue, the scheme of taxation provides that the withholding tax will have to be deducted first even on the exempt income paid to non-residents and a refund can be claimed.

The regulation has however provided relief from withholding tax on certain payments of exempt incomes to non-residents.

<b>Sr. No.</b>	<b>Exempt income paid to non-residents</b>	<b>Position of withholding tax</b>
1	Interest on deposit kept with banks in Qatar and paid to natural persons	Exempt in terms of Article 4 of tax law read with clause 4 of regulation 21
2	Interest on public treasury bonds, development bonds and public corporation bonds	Exempt in terms of Article 4 of tax law read with clause 4 of regulation 21
3	Dividend after payment of tax on profits	Withholding tax to be deducted @ 7%

## **11. Withholding tax on Royalty & Technical Fee**

### **a. Royalties**

The definition of term "royalties" as used in the tax law is similar to the definition used in model tax conventions which includes payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for information (know-how) concerning industrial, commercial or scientific experience.

Royalties shall be deemed to arise in a Contracting State where the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the royalties was incurred and the royalties are borne by that permanent establishment, then such royalties shall be deemed to arise in the State in which the permanent establishment is situated.

Accordingly, the payments made by a resident company in Qatar to use the know-how or patent, etc shall be subject to withholding tax in Qatar at the rate of 5%.

### **b. Payment of Technical Fees**

The payment of fee which includes the payment for technical fee, consultancy fee shall be liable for withholding tax if the services of this nature are rendered in the state of Qatar. However, where the services are rendered from outside Qatar and the recipient of income

does not has a PE in the state of Qatar, the payment in the nature of technical or consultancy fee may not be subject to tax in Qatar merely because of the fact that the payer is a resident of Qatar. In such cases, reference to the tax treaty is essential to determine the taxability of the payment. As stated elsewhere Qatar follows the source rule and where the services are rendered outside the Qatar, such services shall not be liable to tax. Withholding tax of 5% would have to be deducted and a refund to be claimed by non-resident entity.

## **12. Withholding tax on Interest**

Withholding tax on payment of interest shall be liable for tax at the rate of 7% subject to certain exemptions provided in Article 4 of the tax law, clause 4 of regulation 21.

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